*Together with Binyon v. Bateson No. 926

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1969

No. 892

MAGNA OIL CORPORATION, et al.

Petitioners,

v.

PHILIP B. BATESON,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners pray that a Writ of Certiorari issue to review the Judgment of the United States Court of Appeals for the Fifth Circuit entered in the above entitled case on August 11, 1969, as modified by per curiam opinion filed on October 23, 1969, on Petition for Rehearing.(1)

CITATIONS TO OPINIONS BELOW

The opinion of the Court of Appeals, printed in Appendix B hereto, on page 12 is not yet reported.

(1) The Petitioners are as follows: Magna Oil Corporation, G. B. Howell, Vernon C. Howell, Jake B. Goodson, Richard E. Howell, and C. L. Vickers.

JURISDICTION

The judgment of the Court of Appeals was entered on August 11, 1969. R. 127; p. 12 *infra*. Rehearing was denied on October 23, 1969. R. 128; p. 19 *infra*. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. Whether a stockholder who sold his stock and shortly thereafter reacquired stock in the corporation for the purpose of filing a long-planned stockholder's derivative suit has standing to maintain the suit under Rule 23.1 of the Federal Rules of Civil Procedure. (2)

2. Whether the mere allegation that alleged past wrongs are "continuing" can give a United States Court jurisdiction pursuant to Rule 23.1 of the Federal Rules of Civil Procedure over a stockholder's derivative suit for transactions alleged to have occurred prior to stock ownership.

3. Whether a United States Court is required to apply Section 327 of the Delaware Corporation Law (1967) in a stockholder's derivative suit in which jurisdiction is based on diversity of citizenship, and the corporation is a Delaware corporation.

STATUTES INVOLVED

The statutory provisions involved are Rule 23.1 of the Federal Rules of Civil Procedure, and Section 327 of the General Corporation Law of Delaware. They are printed in Appendix A.

STATEMENT OF THE CASE

Prior to May, 1967, Respondent was a stockholder of Peti-

(2) This is a quotation of the question with which Judge Thornberry opened his opinion. (R. 126 p. 1; Appendix B, p. 12 *infra*)

tioner Magna Oil Corporation, a Delaware corporation whose shares of common stock are listed on the American Stock Exchange (R. 26) with 3,043,618 shares outstanding as of March 14, 1967 (R. 23, 67, 68). Commencing at least as early as April of 1966, Petitioner planned a stockholder's derivative action for the wrongs alleged in this action (R. 68). On May 5, 1967, Respondent disposed of the last of some 4200 to 4300 shares of stock in Petitioner Magna Oil Corporation which he had theretofore owned (R. 74), and as of May 5, 1967, Respondent was not a stockholder of Magna Oil Corporation (R. 74, 75). On July 21, 1967, Respondent ordered from a broker 100 shares of stock in Magna Oil Corporation which he paid for on August 18, 1967 (R. 76-78). The 100 shares of stock of Magna were purchased for the purpose of bringing the present suit (R. 68). On September 1, 1967, Respondent received a stock certificate for 100 shares of Common Stock of Magna Oil Corporation (R. 63), the only stock of Magna Oil Corporation owned by Respondent 20 days thereafter, on September 21, 1967, when he filed this lawsuit (R. 78). Jurisdiction was based solely on diversity of citizenship, as Petitioner Magna Oil Corporation is a Delaware corporation with its principal place of business in Texas, all other Petitioners are Texas residents, and Respondent is a New York resident. Thereafter timely motions to dismiss, based on Rule 23.1 of the Federal Rules of Civil Procedure were filed by the various Petitioners with briefs and affidavits attached, in accordance with Rule 12 of the Federal Rules of Civil Procedure, (R. 38-42) and additional material was permitted to be filed pursuant to Rule 12 and Rule 56 (R. 65). Such motions to dismiss were set for hearing on March 1, 1968, on which date the Court indicated its intention of entering an order of dismissal. At such hearing Respondent requested leave of court to file an amended complaint in order to allege that the wrongdoings of which he complained were "con-

tinuing wrongdoings" and the court indicated that Respondent could reduce his motion to writing and it would be overruled. Thereafter, on March 20, 1968, an order granting Petitioners' motion to dismiss was entered by the United States District Court for the Northern District of Texas, (R. 105) and Respondent's motion for leave to amend, with a proposed amended complaint attached, filed on March 20, 1968, which alleged only that an amended complaint would assert the wrongs to be continuing, (R. 78-80) was overruled (R. 105).

The alleged wrongdoings are set out in the lower court's opinion (p. 13 *infra*), except that contrary to the opinion there is no allegation that any Company assets secure personal indebtedness of any Petitioner (R. 92-24 R. 12-14). In its proposed Amended Complaint attached to its motion for leave to amend Respondent included an allegation of violation of 15 U.S.C.A. §78p, against Petitioner G. B. Howell, (R. 91) although not described in the motion for leave to amend, but of course this allegation could at most affect Petitioner G. B. Howell and would have no effect on any of the other Petitioners. The lower court mentioned this allegation in its footnote 1, but did not make it the basis of the decision for which review is sought.

The Court of Appeals treated the proposed amended complaint as having been filed and dismissed by the trial court and reversed the decision of the United States District Court for the Northern District of Texas and remanded the case to the trial court for proceedings not inconsistent with its opinion. The reversal was based on the theory that a former stockholder may acquire stock for the purpose of litigation and by the assertion that there were continuing wrongs not be barred by Rule 23.1.

REASONS FOR GRANTING THE WRIT

1. Although the judgment below is not a final one, it is

appropriate for review because it involves an issue fundamental to the further conduct of the case. *Land v. Dollar*, 330 U.S. 731, 735 n.2 (1947); and see *United States v. General Motors Corp.*, 323 U.S. 373, 377 (1945). If review is not permitted, Petitioners will be deprived of their right to be free from purchased litigation or speculation in wrongs done to corporations prohibited by Rule 23.1 of the Federal Rules of Civil Procedure. It would appear that the right claimed by Petitioners under Rule 23.1 is "separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated", *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 546 (1949). (3)

2. The decision of the Court of Appeals below is directly in conflict with the decision of the Third Circuit Court of Appeals in *Kenrich Corp. v. Miller*, 377 F.2d 312 (3rd Cir. 1967). Although the Court of Appeals for the Fifth Circuit recognizes the universal rule that a litigant who buys stock with knowledge of alleged wrongs may not maintain a derivative action based on these wrongs, it holds that a former stockholder who sells his stock with knowledge of the alleged wrong is not barred from reacquiring stock for the purpose of bringing litigation. The Court used the following language in reaching that result:

> "While a *stranger* to the corporation who buys stock with knowledge of the alleged wrongs may not maintain a derivative action even if the wrongs complained of are continuing wrongs, that rule is not applicable here. Appellant is no stranger to the corporation. He was a long-time

(3) As recognized by this Court in *Cohen v. Beneficial Industrial Loan Corp., supra*, the defense of litigation such as this is expensive and the "nuisance" value of the "strike" suit can make the derivative action a form of legal blackmail. If Rule 23.1 is not applied early in the litigation to protect the parties from litigants without standing, most of its value is dissipated.

> stockholder of Magna who apparently was concerned with the management of the company, and had planned to bring a derivative suit as early as April, 1966. Although it is true that he sold his stock (allegedly through inadvertence), he bought back a hundred shares in the corporation shortly thereafter." (At Appendix B, p. 16, R. 126, p. 7.)

In *Kenrich Corp. v. Miller, supra,* a long-time shareholder, former president and chief executive officer of a corporation sold his stock and later attempted to maintain an action on behalf of the corporation by assignment from the corporation of the cause of action. The Third Circuit described the effect of the sale of stock by such shareholder as follows:

> "One who is a stockholder at the time of an alleged intra-corporate wrong and, knowing of the wrong, thereafter sold his stock has in legal contemplation become a stranger to any controversy about the matter." 377 F. 2d 314.

The lower court in describing the *Kenrich* case, seems to indicate that the distinction in cases is the fact that what was involved in *Kenrich* was the *sale* of stock, and the present case involves a former shareholder who *buys* stock with knowledge of alleged wrongdoing. However, the present case also involves a party who sold his stock with knowledge of the wrongdoings. The court below recognizes that the purchase of stock in order to bring litigation bars standing to sue, but in direct conflict with the Third Circuit in the *Kenrich* case holds that former ownership of stock and sale does not make the former shareholder a "stranger", but gives a litigant who acquires stock for the purpose of litigation a standing not otherwise obtainable. Although the former shareholder in *Kenrich* had an alternative ground upon which he based his standing to sue (a champertous agreement), it was also necessary for the Court to find that no rights as a shareholder remained to one who sells his stock, in order to bar the suit.

3. The decision of the court below is believed to be in conflict with the decision of the United States Court of Appeals for the Seventh Circuit in *Weinhaus v. Gale*, 237 F.2d 197 (7th Cir. 1956) and the United States Court of Appeals for the Third Circuit in *Henis v. Compania Agricola de Guatemala*, 210 F.2d 950 (3rd Cir. 1954) affirming and adopting the decision of the United States District Court for the District of Delaware in *Henis v. Compania Agricola de Guatemala*, 116 F. Supp. 223 (U.S. Del. 1953). In each of the cited cases a party by the device of employing appropriate language in his complaint charged transactions which had previously occurred were "continuing transactions" in order to maintain jurisdiction within the meaning of Rule 23.1 of the Federal Rules of Civil Procedure and the Courts refused to permit this device to be successful. Each of the alleged wrongs set forth in Respondent's original complaint and described in the opinion below are wrongs which occurred prior to the time he acquired his 100 shares of stock, and only by the device of alleging that such wrongs were "continuing" was standing asserted. The position of the Fifth Circuit in the present case has been rejected by the Seventh Circuit and by the Third Circuit on the grounds that in this sense every wrong is a "continuing wrong" until it is remedied and if Rule 23.1 may be defeated by use of appropriate language in the complaint, the Rule is meaningless.

4. Although the sole basis of the jurisdiction of the United States Courts is diversity of citizenship the lower court wholly failed to apply substantive law of Delaware, the State of incorporation of Magna and the applicable substantive law. *McQuillen v. National Cash Register Co.*, 112 F.2d 877, 882 (4th Cir. 1940) *cert. den.* 311 U.S. 685. This Court has never answered the question of whether Rule 23.1 or applicable State laws control, but it is submitted that the plaintiff in a diversity

action choosing to use the federal court, should meet the tests of both laws, treating Rule 23.1 as procedural and Section 327 of the General Corporation Law of Delaware (1967) as substantive. This would be the only rule that would prevent "forum shopping". *Erie R. R. Co. v. Tompkins*, 304 U.S. 64 (1938). In this case state and federal laws are the same, and should bar Respondent's suit.

5. The decision of the court below with respect to the standing of a plaintiff who purchased 100 shares in order to commence litigation for alleged wrongs done to a corporation after having sold all his shares in such corporation with knowledge of such wrongs, is erroneous and in conflict with every authority which has considered this question. The court below cited no authority for the proposition. The holding is not only contrary to federal authorities cited above, but is directly contrary to *Gresov v. Shattuck Denn Mining Corp.*, 243 N.Y.S.2d 760 (N.Y. Sup. 1963) and the rationale of all of the Delaware authorities (the applicable substantive state law) applying what is now Section 327 of the General Corporation Law of Delaware, formerly Section 51A of the Delaware Code. See *Rosenthal v. Burry Biscuit Corp.*, 60 A.2d 106 (Del. Ch. 1948); *Maclary v. Pleasant Hills, Inc.*, 109 A.2d 830 (Del. Ch. 1954); and *Newkirk v. W. J. Rainey, Inc.*, 76 A.2d 121 (Del. Ch. 1950). Further, the rationale of the court below is in conflict in principle with the exposition of the meaning of the requirements of Rule 23 of the Federal Rules as set forth by this Court in *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949) in which this Court described Rule 23 as follows:

> "Rule 23 requires the stockholder's complaint to be verified by oath and to show that the plaintiff was a stockholder at the time of the transaction of which he complains or that his share thereafter devolved upon him by operation of law. In other words, the federal court will not

> permit itself to be used to litigate a purchased grievance or become a party to speculation in wrongs done to corporations." (337 U.S. 556)

The position that a former stockholder has a greater right to speculate in the wrongs of corporations than does a person who never owned stock at all, seems logically indefensible.

6. The question presented is of importance to the administration of the Federal Rules of Civil Procedure. In view of recent decisions particularly by lower United States Courts, stockholder derivative suits have become increasingly numerous and the whole subject of director liability is one which is occupying the attention of the public and the bar. Illlustrative of the growing interest in such litigation are the numerous law review articles on subjects such as director liability, and insurance against such liability. A partial list of some recent articles is set forth in Appendix C. The decision of the lower court constitutes a significant and important interpretation of Rule 23.1 of the Federal Rules of Civil Procedure and by granting this petition this Court may resolve the conflicts in the Circuits and clarify Rule 23.1 in the context of an undisputed fact situation, uncluttered by a record burdened with the unrelated merits of the alleged cause.

CONCLUSION

For the foregoing reasons, this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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November 26, 1969.

APPENDIX A

Rule 23.1, Federal Rules of Civil Procedure

Rule 23.1. Derivative Actions by Shareholders.

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

Section 327, Delaware General Corporation Law

Stockholder's derivative action; allegation of stock ownership

In any derivative suit instituted by a stockholder of a corporation, it shall be averred in the complaint that the plaintiff was a stockholder of the corporation at the time of the transaction of which he complains or that his stock thereafter devolved upon him by operation of law.

APPENDIX B

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 26130

PHILIP B. BATESON,
Plaintiff-Appellant,

versus

MAGNA OIL CORPORATION, et al.,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas

(August 11, 1969)

Before THORNBERRY and SIMPSON, Circuit Judges, and CASSIBRY, District Judge.

THORNBERRY, Circuit Judge: The question presented is whether a stockholder who sold his stock and shortly thereafter re-acquired stock in the corporation for the purpose of filing a long-planned stockholders' derivative suit has standing to maintain the suit under Rule 23.1 of the Federal Rules of Civil Procedure. We hold that he does.

Appellant filed a stockholders' derivative suit on behalf of Magna Oil Corporation against the directors of the corporation. He seeks recovery for the benefit of the corporation for damages resulting to the corporation from alleged acts of fraud, mismanagement, conspiracy, and breach of fiduciary duty on the part of the defendant directors. Appellant complained of six transactions, five of which are alleged to be continuing transactions begun before the filing of the action and continuing at the time of the filing of the suit.[1]

The five transactions that are alleged to be continuous in nature are: (1) That defendant Howell caused Magna to advance him money on open account and promissory note. (2) That defendant Howell caused Magna to buy an airplane which is used more for the benefit of Howell than for the Corporation. (3) That defendant Howell has caused Magna to pay him and his brother excessive salaries and expense allowances. (4) That defendant Howell has caused the Corporation's property to be mortgaged at a nearly prohibitive rate in order to secure the payment of Howell's personal indebtedness. (5) That defendant Howell has caused certain of Magna's oil and gas properties to be mismanaged.

Appellant owned several hundred shares of Magna stock continuously from 1956 to May 5, 1967. On the latter date all of his Magna stock was sold. Appellant stated in his deposition that he had intended to retain one or two hundred shares because "he had long since planned this suit." On July 21, 1967, appellant bought one hundred shares of Magna stock for the

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[1]The sixth transaction complained of involves insider short-swing profits and an alleged violation of the Securities Exchange Act of 1934. It has been held that since an action to recover insider short-swing profits may be brought "by the owner of any security," 15 U.S.C.A. § 78p, plaintiff need not allege that he was a stockholder at the time of the transaction complained of. *Blau v. Mission Corp.*, 2d Cir. 1954, 212 F.2d 77, cert. denied, 347 U.S. 1016, 74 S.Ct. 872, 98 L.Ed. 1138.

stated purpose of bringing this suit. He filed suit on September 21, 1967. The lower court dismissed the action, apparently on the basis that the "contemporaneous ownership" requirement of Rule 23.1 had not been met.[2] Appellant appeals that decision.

The Rule makes it clear that one who buys stock in the corporation cannnot maintain a stockholders' derivative suit if the wrongs complained of were completed before his acquisition of stock. However, where the complaint charged continuing wrongs, occurring at the time plaintiff owned stock, the complaint should not be dismissed on defendant's contention that the claims actually arose prior to the time plaintiff acquired his stock. 1 Barron & Holtzoff, *Federal Practice and Procedure* § 566, p. 303 (Wright ed. 1961); *Hoover v. Allen*, D.C.N.Y. 1960, 180 F. Supp. 263. In other words, the requirement that a shareholder must have owned stock at the time of the wrong of which he complains may be satisfied if the wrong is a continuing one; that is, if it "spans the plaintiff's ownership, or if new elements in a pattern of wrongful conduct occur after acquisition." Prunty, *Business Associations*, 35 N.Y.U.L. Rev. 1468 (1960).

This Court has set forth certain guidelines and tests for continuing transactions. In *Palmer v. Morris*, 5th Cir. 1963, 316 F.2d 649, the plaintiff charged the defendants with wrongdoing for certain transactions entered into prior to plaintiff's acquisition of the stock. It was alleged, however, that the company was still paying out sums of money pursuant to the earlier transactions and that these sums of money, both in the form of allegedly non-beneficial services for the company and in the

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[2]Rule 23.1 requires, inter alia, that in a stockholder's derivative action, the complaint shall allege "that the plaintiff was a shareholder . . . at the time of the transaction of which he complains." This requirement serves the dual purpose of preventing a collusive attempt to invoke federal jurisdiction, *Hawes v. City of Oakland*. 1882, 104 U.S. 450, 26 L.Ed. 827, and of preventing a person from buying a lawsuit.

form of allegedly exorbitant rentals, were still being made. The Court stated:

> Each of the counts . . . sufficiently stated the facts and circumstances touching on the alleged illegality of the payments currently being made so that these counts could not be dismissed as dealing only with transactions that had completely occurred and been terminated prior to plaintiff's acquisition of his stock. We are unable upon the basis of the record itself to determine that as a matter of law these counts failed to assert illegal conduct by the officers of the company subsequent to the acquisition of the stock by the plaintiff and at a time when he had a right to complain thereabout.

Id. at 650.

The matters complained of in the present case are not wrongs that have "completely occurred and been terminated prior to plaintiff's acquisition of his stock," and therefore, under the *Palmer* test, are continuing wrongs. Thus it would seem that appellant has met the requirement of owning stock at the time of the wrong complained of because the alleged wrongs were continuing at the time he re-acquired stock in Magna.

Appellees claim, however, that this suit was properly dismissed because appellant had knowledge of the alleged wrongs at the time he re-acquired his stock, and stock acquired with such knowledge cannot give standing to sue regardless of whether the allegedly wrongful acts were "continuing wrongs." In support of this argument, appellees place strong reliance on *Kenrich Corp. v. Miller*, 3d Cir. 1967, 377 F.2d 312, in which the court stated that one who was a stockholder at the time of an alleged intracorporate wrong and *sells* his stock with knowledge of the wrong loses any rights he may have had to bring suit in behalf of the corporation. That case, however, is not in point. There, the plaintiff had been the president and principal

stockholder in the company, but he had sold all of his stock two years before the suit was instituted. He sought to maintain the suit by way of an assignment from another stockholder, and there was a finding that the assignment was champertous. Clearly, there was strong reason for applying estoppel principles against that plaintiff, whose apparent purpose in maintaining the derivative suit was to gain personal profit.

Estoppel principles will also work to deny standing to a plaintiff who *buys* stock with knowledge of the wrongs of which he complains. *See, e.g., Von Schlemmer v. Keystone Life Ins. Co.*, 121 La.2d 987, 46 So. 991 (1908); *Wagner Electric Corporation v. Hydraulic Brake Co.*, 269 Mich. 560, 257 N.W. 884 (1934). While a *stranger* to the corporation who buys stock with knowledge of the alleged wrongs may not maintain a derivative action even if the wrongs complained of are continuing wrongs, that rule is not applicable here. Appellant is no stranger to the corporation. He was a long-time stockholder of Magna who apparently was concerned with the management of the company, and had planned to bring a derivative suit as early as April, 1966. Although it is true that he sold his stock (allegedly through inadvertence), he bought back a hundred shares in the corporation shortly thereafter. He bears no resemblance to the outsider who finds out about intracorporate misconduct and buys stock to foment litigation. Appellees' argument that appellant does not have standing to maintain this action loses sight of the purpose of Rule 23.1. That purpose is to prevent the federal court from being used to litigate purchased grievances or from becoming a party to speculative suits against corporations. *Cohen v. Beneficial Industrial Loan Corp.*, 1949, 337 U.S. 541, 556, 69 S. Ct. 1221, 1230, 93 L.Ed. 1541. Certainly, it cannot be said that appellant is litigating a purchased grievance. He is not a speculative litigator. Therefore, it would exalt form

over substance to hold that appellant did not have standing to maintain this stockholders' derivative action. Appellant should have his day in court.

The order of the trial court dismissing the Complaint was erroneous and the order is VACATED and set aside. The case is REMANDED to the trial court for proceedings not inconsistent with this opinion.

United States Court of Appeals
FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1968

No. 26130

D. C. Docket No. 3-2241-Civil Action

PHILIP B. BATESON,
Plaintiff-Appellant,

versus

MAGNA OIL CORPORATION, ET AL,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas.

Before THORNBERRY and SIMPSON, Circuit Judges, and CASSIBRY, District Judge.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, vacated; and that this cause be, and it is hereby remanded to the said District Court for proceedings not inconsistent with the opinion of this Court;

It is further ordered that defendants-appellees pay to plaintiff-appellant the costs on appeal to be taxed by the Clerk of this Court.

August 11, 1969

Issued as Mandate:

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 26130

PHILIP B. BATESON,

Appellant,

versus

MAGNA OIL CORPORATION, ET AL,

Appellees.

Appeal from the United States District Court for the Northern District of Texas

ON PETITIONS FOR REHEARING

(October 23, 1969)

Before THORNBERRY and SIMPSON, Circuit Judges, and CASSIBRY, District Judge

PER CURIAM: It is ORDERED that the petitions for rehearing filed the above entitled and numbered cause be and the same are hereby denied, except that the first sentence of the first paragraph on page 5 of the slip opinion dated August 11, 1969, is modified to read as follows: "With the possible exception of transaction (1), the matters complained of in the present case are not wrongs that have 'completely occurred and been terminated prior to plaintiff's acquisition of his stock,' and therefore, under the *Palmer* test, are continuing wrongs."

APPENDIX C

Directors Liability and Indemnification

Adkins and Janis, *Some Observations on Liabilities of Corporate Directors*, 20 BUS. LAW. 817 (1965)

Anderson, *Directors and Officers Liability Insurance*, 47 CHI. BAR REC. 31 (1965)

Barker, *Coverage for Tort Liability of Officers, Directors and Stockholders*, 1967 ABA SEC. ON INS. N. & C.L. 413

Bishop, *Indemnification of Corporate Directors, Officers and Employees*, 20 BUS. LAW. 833 (1965)

Bishop, *New Cure For an Old Ailment: Insurance Against Directors and Officers Liability*, 22 BUS. LAW. 92 (1966)

Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078 (1968)

Brook, *Officers and Directors Liability Insurance*, 2 FORUM 228 (1967)

Cheek, *Control of Corporate Indemnification: A Proposed Statute*, 22 VAND. L. REV. 255 (1969)

Dyson, *Directors Liability For Negligence*, 40 IND. L.J. 341 (1965)

Hinsey and Delancey, *Directors and Officers Liability Insurance*, 23 BUS. LAW. 869 (1968)

Jennings, *Insider Trading in Corporate Securities: A Survey of Hazards and Disclosure Obligations* under Rule 10b-5, 62 NW. U.L. REV. 809 (1968)

Mace, *Directors and Officers Liability Insurance*, 85 BANKING L. J. 39 (1968)

McIntyre, *Directors and Officers Liability Insurance*, 42 LOS ANGELES BAR BULL. 57 (1966)

Riemer, *Personal Liability of Corporate Officer for Purchases Made without Disclosure of his Representative Capacity*, 72 COMMERCIAL L.J. 5 (1967)

Sebring, *Recent Legislative Changes in the Law of Indemnification of Directors, Officers and Others*, 23 BUS. LAW. 95 (1967)

Snow, *Liability of Directors and Officers of Corporation*, 17 DEFENSE L.J. 521 (1968)

Note, *Corporate Indemnification of Directors and Officers*, 18 CATHOLIC U.L. REV. 195 (1968)

Note, *Public Policy and Directors Liability Insurance*, 67 COLUM. L. REV. 716 (1967)

Note, *Insider Trading: The Issuer's Disposition of an Alleged* 16(b) *Violation*, 1968 DUKE L.J. 94

Note, *Liability Insurance for Corporate Executives*, 80 HARV. L. REV. 648 (1967)

Note, *Insider Liabilities Examined*, 18 SYRACUSE L. REV. 808 (1967)

Note, *Factors That Limit the Negligence Liability of a Corporate Executive or Director*, 1967 U. ILL. L. F. 341

Note, *Antitrust Laws and the Corporate Executive's Civil Damage Liability*, 18 VAND. L. REV. 1938 (1965)

Note, *Liability of Officers and Directors Who Continue the Business of a Corporation after the Forfeiture of its Charter*, 1967 WASH. U.L.Q. 222

Comment, 71 DICK. L. REV. 668 (1967)

Comment, 19 S.C. L. REV. 854 (1967)

Comment, 35 TENN. L. REV. 673 (1968)

Forum on Insurance against Liabilities of Directors and Officers, 22 RECORD OF BAR ASS'N OF CITY OF N.Y. 342 (1967)

Symposium on Duties and Liabilities of Corporate Directors, 22 BUS. LAW. 29 1966)

Stockholders Derivative Suits

Dykstra, *Revival of the Derivative Suit*, 116 U. PA. L. REV. 74 (1967)

Green, *Civil Liability to Stockholders Under the Securities Act*

of 1933 and Remedy by Class Action, 2 SAN DIEGO L. REV. 34 (1965)

Haudek, *Settlement and Dismissal of Stockholder's Actions*, 22 Sw.L.J. 767 (1968)

Hornstein, *Shareholder's Derivative Suit in the United States*, 1967 J. BUS. L. 282

Lowenfels, *Rule 10b-5 and the Stockholders Derivative Action*, 18 VAND. L. REV. 893 (1966)

Note, *Shareholder's Derivative Suit to Enforce a Corporate Right of Action Against Directors Under SEC Rule 10b-5*, 114 U. PA. L. REV. 578 (1966)

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In the

Supreme Court of the United States

OCTOBER TERM, 1969

No. 926

DUDLEY E. BINYON,
Petitioner,

v.

PHILIP B. BATESON,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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DUDLEY E. BINYON,

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v.

PHILIP B. BATESON,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Petitioner, DUDLEY E. BINYON, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on August 11, 1969, as modified by *per curiam* opinion dated October 23, 1969, denying Petitions for Rehearing.

CITATION TO OPINION BELOW

The opinion of the Court of Appeals is reported at 414 F. 2d 128, and is printed in Appendix B hereto, *infra*, p. 21.

No opinion was rendered by the District Court for the Northern District of Texas.

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was entered on August 11, 1969, Appendix B, *infra*, p. 26. Timely Petitions for Rehearing were denied on October 23, 1969. R. 128; p. 27 *infra*. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1).

QUESTIONS PRESENTED

1. Whether a stockholder who merely alleges that certain alleged wrongs, having their inception prior to the stockholder's purchase of stock in the corporation, are "continuing" has standing to institute a stockholders' derivative suit under Rule 23.1 of the Federal Rules of Civil Procedure.

2. Whether a stockholder who purchases stock in a corporation for the sole and exclusive purpose of bringing a stockholder's derivative suit based on alleged wrongs having their inception prior to his purchase of stock and of which he had full knowledge at the time of such purchase has standing to institute a stockholder's derivative suit by reason of his status as a former stockholder of the corporation.

3. Whether one who was a stockholder at the time of alleged intra-corporate wrongs and, having knowledge of such alleged wrongs, thereafter sells his stock has standing upon repurchase of stock in the corporation to bring a stockholder's derivative suit based upon such alleged wrongs.

STATUTORY PROVISIONS INVOLVED

Rule 23.1 of the Federal Rules of Civil Procedure, which deals with derivative actions by shareholders. Rule 23.1 is reprinted in Appendix A, p. 19 *infra*.

STATEMENT OF THE CASE

On September 21, 1967, Philip B. Bateson, Plaintiff below and the Respondent herein, filed a stockholder's derivative action seeking recovery on behalf and for the benefit of Magna Oil Corporation, whose shares are listed on the American Stock Exchange, for damages which were alleged to have resulted from certain acts of fraud, mismanagement and breach of fiduciary duty on the part of the members of the Board of Directors of Magna Oil Corporation. Respondent also named the corporation as a Defendant in his complaint. Petitioner is a member of the Board of Directors of Magna Oil Corporation.[1]

Respondent had been a shareholder of Magna Oil Corporation for a number of years prior to May of 1967. However, Respondent testified during his deposition, taken on November 8 and November 9, 1967, that he had sold all of his shares of Magna Oil Corporation (approximately 4200 or 4300 shares) by May 5, 1967 (R. 74). Respondent further testified on his deposition that he had sold his shares in Magna Oil Corporation because he knew that certain loans with the Republic National Bank of Dallas were coming up for

[1]The other members of the Board of Directors are G. B. Howell, Jake B. Goodson, Vernon C. Howell, C. L. Vickers and Richard E. Howell. These remaining directors named defendants in the suit and Magna Oil Corporation are filing a separate petition for a writ of certiorari with this Court.

attempted renewal by Magna Oil Corporation in June, 1967 (R. 67). Respondent, however, alleged that he had intended to keep 100 or 200 shares of Magna Oil Corporation stock and through alleged inadvertence this had not been done (R. 68). It was also brought out in Respondent's deposition that Respondent ordered 100 shares of Magna Oil Corporation stock from a broker on July 21, 1967, for the sole and exclusive purpose of instituting the present derivative suit (R. 68). Respondent further testified that as early as April, 1966, he had advised all Directors of Magna Oil Corporation at a stockholders' meeting that he intended to bring a stockholder's derivative action for the wrongs alleged in this suit (R. 68). Respondent received a stock certificate for the 100 shares of stock of Magna Oil Corporation on September 1, 1967, and twenty (20) days thereafter, on September 21, 1967, filed this derivative shareholder's suit. The sole basis of jurisdiction was diversity of citizenship, Magna Oil Corporation being a Delaware corporation with its principal place of business in Texas, all of the Directors being Texas residents and Respondent being a resident of the State of New York.

Motions to dismiss with supporting briefs and affidavits were filed by the various Defendants below, including Petitioner, on October 11, 1967, on October 12, 1967, and on November 6, 1967 (R. 38-42). These various motions to dismiss were set for hearing on March 1, 1968, on which date, immediately prior to the hearing, Respondent filed his reply to the Defendants' motions to dismiss (R. 60) and his supporting brief (R. 121).

At the hearing on the motions to dismiss held March 1, 1968, and after the Court had announced the granting of such motions, Respondent indicated that he desired to file an amended complaint so that he might aver that all of the alleged wrongs were "continuing wrongs". The second paragraph of the Court's Order Granting Motions of Defendants to Dismiss (R. 105, 106) states:

> "During the hearing Plaintiff in open court requested leave to amend his pleading so that he might aver that all of the alleged wrongs complained of in his complaint were continuing wrongs. The court stated that the Plaintiff could reduce said motion for leave to amend to writing and the same would be overruled."

Thereafter, on March 20, 1968, the Order Granting Motions of Defendants to Dismiss was entered by the United States District Court for the Northern District of Texas without opinion. Respondent's Motion for Leave to Amend, with a proposed amended complaint attached, was filed on March 20, 1968 (R. 79, 80). This motion, alleging in substance that the amended complaint would assert the alleged wrongs to be continuing and that Defendant G. B. Howell failed to appear and give his deposition, was overruled.

The alleged wrongdoings are set out on page 2, paragraph 2 of the Fifth Circuit's opinion (p. 22, *infra*), except that contrary to the opinion there is no allegation that any of the corporation's assets were mortgaged to secure personal indebtedness of any of the Directors, but rather the allegation is that Director G. B. Howell's bad financial condition has caused the lending institution to

place Magna Oil Corporation in bad financial condition. (R. 92-94, R. 12-14). In Respondent's proposed Amended Complaint, attached to his motion to amend, Respondent included an allegation purported to be a violation of 15 U.S.C.A. § 78p. against Director G. B. Howell, (R. 91) although not mentioned in Respondent's motion to amend. This allegation could at most affect only Director G. B. Howell and would have no effect on any of the other Director-Defendants. The Fifth Circuit mentioned this allegation in its footnote 1, but did not make it the basis of the decision for which review is sought.

The Fifth Circuit held, in reversing and remanding the District Court's decision, that the matters complained of in the present case were alleged to be wrongs that had not completely occurred and terminated prior to Respondent's purchase of his 100 shares of stock and that Respondent had met the requirement of Rule 23.1 of owning stock at the time of the wrong complained of because the wrongs were alleged to be "continuing" at the time Respondent reacquired stock in Magna Oil Corporation. In addition, the Court of Appeals held that while a "stranger" to a corporation who buys stock with knowledge of the alleged wrongs made the basis of a derivative suit may not maintain a derivative action, even if the wrongs complained of are "continuing wrongs", this rule of law was not applicable in the present case because the Respondent was not a "stranger" to the corporation since he had formerly been a long-time stockholder of Magna Oil Corporation.

REASONS FOR GRANTING THE WRIT

1. The decision of the Fifth Circuit below is in conflict with the decision of the United States Court of Appeals for the Seventh Circuit in *Weinhaus v. Galé*, 237 F. 2d 197 (7th Cir. 1956) and the decision of the United States Court of Appeals for the Third Circuit in *Henis v. Compania Agricola de Guatemala*, 210 F. 2d 950 (3rd Cir. 1954) affirming and adopting the decision of the United States District Court for the District of Delaware in *Henis v. Compania Agricola de Guatemala*, 116 F. Supp. 223 (U.S. Del. 1953). In addition, the Fifth Circuit's opinion is representative of the conflicting views and confusion existing in the Courts of Appeals and Federal District Courts in relation to the application of the concept of "continuing wrongs". This situation has created a substantial area of disorder in the area of derivative shareholder suits in the Federal Courts. Rule 23.1 of the Federal Rules of Civil Procedure requires an allegation in the complaint of a plaintiff in a derivative action that the plaintiff was a shareholder at the time of the transactions of which he complains. The Fifth Circuit, in its opinion in this proceeding, stated that where the complaint alleges "continuing wrongs", occurring at the time a plaintiff brings his derivative suit, the complaint should not be dismissed on a defendant's contention that the claims actually occurred prior to the time the plaintiff acquired his stock (p. 23 *infra.*) While there is authority in support of the theory of "continuing wrongs", the practice of alleging

"continuing wrongs" as a means of satisfying the pleading requirement as to contemporaneous ownership under Rule 23.1 has often been rejected by the Federal Courts. In both the Seventh Circuit and Third Circuit cases cited above a party by the device of employing appropriate language in his complaint, alleged that transactions which had previously occurred were "continuing transactions" in order to maintain jurisdiction under Rule 23.1 of the Federal Rules of Civil Procedure. The Courts in each case refused to permit this device to be used to satisfy the requirement of Rule 23.1. In addition, such a device has been rejected in numerous Federal District Court cases, an example being the recent case of *deHaas v. Empire Petroleum Company*, 286 F. Supp. 809 (D.C. Col. 1968) in which the Court stated at page 812:

> "* * * The transactions complained of in this case occurred between January and August of 1962. Since neither Riggins nor Wiley purchased his stock until sometime in 1964, both must be dismissed as parties to this suit. Their standing is not enhanced by the allegation in the complaint that the fraud is of a 'continuing' nature. As indicated in Pergament v. Frazer, 92 F. Supp. 9, 12 (E.D. Mich. 1949), 'every harm to a corporation is "continuing" when someone has taken away some of its assets wrongfully'. Rule 23.1(1) clearly requires that the plaintiff be a shareholder when the transactions occurred, and a mere allegation of 'continuing' fraud cannot deprive the Rule of its obvious intent. See also, Matthies v. Seymour Mfg. Co., 270 F. 2d 365, 373 (2nd Cir. 1959); Weinhaus v. Gale, 237 F. 2d 197, 200 (7th Cir. 1956); and Henis v. Compania Agricola de Guatemala, 210 F. 2d 950 (3rd Cir. 1954).
>
> Plaintiffs Riggins and Wiley will therefore be dismissed from the suit."

In addition, the only logical or plausible reason for the development of the "continuing wrongs" exception was to prevent a person who purchased stock in a corporation without knowledge of said wrongs from being precluded from rectifying such a situation on the ground that such wrongs had their inception prior to his purchase. However, permitting the use of the exception of "continuing wrongs" to allow such a suit without requiring a showing of good faith would completely defeat the whole purpose of Rule 23.1 of the Federal Rules of Civil Procedure. Since the primary purpose of this rule is the prevention of speculation in lawsuits and the purchase of lawsuits, the availability of the doctrine of "continuing wrongs" without a requisite showing of good faith would inevitably result in just such speculation and purchase of lawsuits.

As a result of the Fifth Circuit's direct conflict with the opinions of the Seventh Circuit and Third Circuit, as evidenced in this proceeding, and with the conflicts and confusion existing in numerous District Court opinions, it is obvious that the Federal Courts are in a state of disorder regarding the theory and application of "continuing wrongs" in relation to derivative suits under Rule 23.1 and there exists an urgent need for a uniform rule of law on this point due to the large number of such cases now being brought in Federal Courts. These conflicts and the lack of uniformity in such an important and frequently litigated

area justify the grant of certiorari to review the judgment below. See *Hanna v. Plumer*, 380 U.S. 460, 463 (1965).

2. The Fifth Circuit, in its opinion in this case, has created a new rule of law relating to derivative shareholder suits which is in conflict in principle with decisions of the United States Supreme Court and which is so inconsistent in theory that it leaves the intent and purpose of Rule 23.1 of the Federal Rules of Civil Procedure in a state of uncertainty. In the case of *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949), Mr. Justice Jackson, speaking for the Court at p. 556 states:

> "Rule 23 requires the stockholder's Complaint to be verified by oath and to show that the plaintiff was a stockholder at the time of the transaction of which he complains or that his shares thereafter devolved upon him by operation of law. In other words, the federal court will not permit itself to be used to litigate a purchased grievance or become a party to speculation in wrongs done to corporations."

The Fifth Circuit, in its opinion below, expressly acknowledges the fact that Respondent had knowledge of the alleged wrongs made the basis of this derivative suit at the time Respondent purchased his 100 shares of stock on July 21, 1967, and that such shares were by the Respondent's own admission purchased for the sole and exclusive purpose of bringing this derivative action. The Fifth Circuit, in its opinion, also expressly recognized the rule of law that a "stranger" to a corporation who buys stock with knowl-

edge of alleged wrongs may not maintain a derivative action based upon said wrongs even if the wrongs complained of are "continuing wrongs" (R. 128). The Court in its opinion also expressly recognized that the primary purpose of Rule 23.1 is to prevent the Federal Courts from being used to litigate purchased grievances or from becoming a party to speculative suits against corporations. In spite of such recognition by the Fifth Circuit, and the fact that Respondent, by his own admission, purchased with full knowledge of the alleged wrongs and for the sole and exclusive purpose of instituting this derivative suit based on those wrongs, the Fifth Circuit holds that Respondent is not precluded from maintaining his suit because Respondent had formerly been a long-time stockholder of the corporation and was, therefore, not a "stranger" to the corporation. In so holding, the Fifth Circuit has created a new rule of law establishing an exception to the principle laid down in *Cohen v. Beneficial Industrial Loan Corp., supra,* and which is in conflict in principle with the primary purpose of Rule 23.1. The result of this holding by the Fifth Circuit is that it will now be necessary to ascertain in derivative shareholder suits whether or not a plaintiff occupies the position of a "stranger" to the corporation. If he does not occupy the position of a "stranger" to the corporation, he will, under the reasoning of the Fifth Circuit's opinion, have standing to institute a derivative shareholder suit regardless of the limitations set forth in Rule

23.1 or any other rule of law which might otherwise preclude a plaintiff from having standing to institute such a derivative suit. The creation of such an exception is inconsistent in theory with the purpose of Rule 23.1 and leaves the intent and meaning of Rule 23.1 in a state of confusion. As stated by this Court in *Schlagenhauf v. Holder*, 379 U.S. 104 (1964), the Federal Rules of Civil Procedure should be liberally construed, but they should not be expanded by disregarding plainly expressed limitations. This is clearly what the Fifth Circuit, in its opinion in this case, has done. In addition, this Court has held that when the language of a rule of procedure is clear and unambiguous and permits of only one reasonable construction, that rule must be enforced according to its terms. *United States v. Robinson*, 361 U.S. 220 (1959).

In addition to the fact that the creation of such an exception to Rule 23.1 is in direct conflict with the above stated rules of law and practice in the Federal Courts, and the express language of Rule 23.1 of the Federal Rules of Civil Procedure, the Fifth Circuit's reasoning in creating such a rule of law is totally unsound and logically indefensible. The Fifth Circuit reasons that because the Respondent had previously been a long-time shareholder prior to his disposition of his substantial block of stock in the corporation and his reacquisition of a nominal amount of stock for the sole purpose of purchasing the right to bring this derivative action, he should not be considered a "stranger" to the corporation. Thus, according to the reasoning of the Fifth Circuit, the Respondent cannot be said to

be litigating a purchased grievance, cannot be considered a speculative litigator nor would the other rules of law which would deny standing to Respondent be applicable. This reasoning of the Fifth Circuit that prior ownership alone is capable of creating a presumption that the stockholder is not, upon reacquisition of stock in the corporation, purchasing a lawsuit or speculating in litigation, is totally without merit. Merely because the Respondent may have originally had the best interests of the corporation in mind does not mean that such would necessarily be the case at the time of reacquisition of stock for the sole purpose of instituting a derivative shareholder's suit. In fact, just the opposite should be presumed where, as in this proceeding, the Respondent sold a substantial block of stock and later reacquired only a nominal amount for the express and limited purpose of bringing this derivative action. In other words, it cannot be assumed that Respondent is not a purchaser of a lawsuit or speculator in litigation merely because he had formerly owned stock in a corporation. Due to the large number of individuals who are constantly purchasing and selling stock in public corporations, this rule of law creating an exception to Rule 23.1, based upon whether or not a plaintiff is categorized as a "stranger" to the corporation, will in all probability result in many instances in rendering the intended purpose and application of Rule 23.1 a nullity. Such a situation clearly requires the exercise of this Court's power and duty of supervision over the Federal Rules of Civil Procedure.

3. The decision of the Court of Appeals in this proceeding is directly in conflict with the decision of the United States

Court of Appeals for the Third Circuit in *Kenrich Corp. v. Miller*, 377 F. 2d 312 (3rd Cir. 1967). The Fifth Circuit, in its opinion below, stated that the Petitioner and other Defendant placed strong reliance on *Kenrich Corp. v. Miller, supra.* The Fifth Circuit stated that the Defendants cited this case in support of the proposition that because Respondent had knowledge of the alleged wrongs at the time he reacquired his stock, stock reacquired with such knowledge cannot give standing to sue regardless of whether the alleged wrongful acts were "continuing wrongs." This is not the rule of law upon which the *Kenrich* case is based, nor the rule of law for which the Petitioner and the other Defendants below cited the *Kenrich* case. The *Kenrich* case stands as a separate and distinct basis for precluding Respondent from maintaining this derivative action, a basis separate and apart from any rule of law relating to knowledge of the Respondent of the alleged wrongs at the time he reacquired stock in Magna Oil Corporation. The Court, in the *Kenrich* case, at p. 314, stated that:

> "One who was a stockholder at the time of intra-corporate wrong and, knowing of the wrong, thereafter sold his stock has in legal contemplation become a stranger to any controversy about the matter. Mitchell v. Beachy, 1921, 110 Kan. 60, 202 p. 268. Admittedly, Kline knew of the alleged wrongs when he sold his stock."

Such a sale, in effect, constitutes a waiver of all rights to maintain a derivative suit based on such intra-corporate wrongs of which the Respondent had knowledge at the time of his original sale of all of his stock of Magna Oil Corpora-

tion and constitutes a basis for denying standing in this suit separate and distinct from the rule stated by the Fifth Circuit relating to the estoppel of a purchaser of stock with knowledge of intra-corporate wrongs to maintain a derivative suit. Both rules of law should apply regardless of the alleged designation of the wrongs as "continuing wrongs." The opinion of the Fifth Circuit, in holding that the *Kenrich* case is not applicable to the case before this Court, clearly demonstrates that the Court erred in its construction of the holding in the *Kenrich* case. In addition, the Fifth Circuit, in its opinion, distinguishes the *Kenrich* case from the case before this Court solely on the basis that the stockholder in the *Kenrich* case sought to maintain suit by way of an assignment and there was a finding that the assignment was champertous which constituted additional equitable grounds for denying the plaintiff in *Kenrich* the right to maintain suit. Such a construction of the case by the Fifth Circuit is clearly erroneous. In reality, the Court in the *Kenrich* case was dealing with two separate and distinct grounds upon which the suit by the plaintiff might have been maintained, neither dependent upon the other in a determination of whether either would supply the plaintiff with standing to bring his suit. The Court in the *Kenrich* case first dealt with the right of the plaintiff to maintain suit based upon an assignment to the plaintiff by Kenrich Corporation of a direct cause of action of Kenrich Corporation against the former directors of a corporation, which had been merged into Kenrich Corporation, for intra-corporate wrongs by the directors of the merged corporation.

The plaintiff was a former stockholder of the merged corporation. Accordingly, it was held that the plaintiff could not maintain suit on the basis of the assignment because the assignment was champertous. However, since the plaintiff's complaint in the *Kenrich* case on its face indicated nothing more than a pure derivative suit seeking redress for harms suffered by a Delaware corporation at the hands of its former directors, the Court had to determine the separate and distinct question of whether the plaintiff had standing individually as a former stockholder of the merged corporation to maintain a derivative stockholder's suit against the former directors of the merged corporation without reference to the assignment mentioned above. As stated above, the Court held that "One who was a stockholder at the time of alleged intra-corporate wrong and, knowing of the wrong, thereafter sells his stock has in legal contemplation become a stranger to any controversy about the matter." As also stated above, the Court in the *Kenrich* case was dealing with two separate and distinct grounds upon which the suit by the plaintiff could have been maintained, neither dependent upon the other in a determination of whether either would supply the plaintiff with standing to bring his suit. Consequently, it is abundantly clear that the Fifth Circuit, in this case, misconstrued the holding in the *Kenrich* case and, as a result of such erroneous construction, has handed down a decision which is in direct conflict with the holding in the *Kenrich* case. The importance of this question and the existence of such conflict

clearly makes it necessary for this Court to exercise its powers of supervision over the Federal Rules of Civil Procedure.

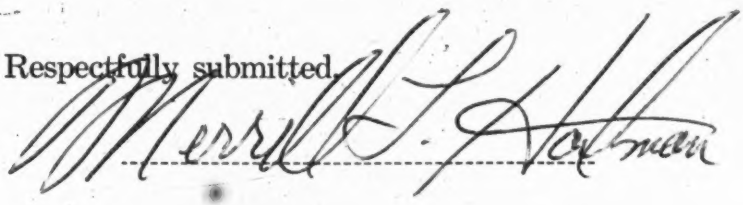
4. Although this Petitioner is asking this Court to review a non-final judgment, the issues of law in this case are fundamental to the further conduct of the case. *Land v. Dollar*, 330 U.S. 731, 735 n. 2 (1947); *Gillespie v. United States Steel Corp.*, 379 U.S. 148, 153 (1964); *United States v. General Motors Corp.*, 323 U.S. 373, 377 (1945); *Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 685 n. 3 (1948). If review is not permitted, Petitioner will be deprived of the right to be free from purchased litigation or speculation in wrongs done to a corporation prohibited by Rule 23.1 of the Federal Rules of Civil Procedure. It appears that the right claimed by Petitioners under Rule 23.1 is "separable from, and collateral to, rights asserted in the action, too important to be denied review and to be independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated". *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 546 (1949).

CONCLUSION

On the Supreme Court rests the prime responsibility for the proper functioning of the Federal Judiciary. Because of the threat to the goal of uniformity of federal procedure posed by this decision of the Fifth Circuit and the need for a uniform rule of law on the points of procedure raised in

this petition and because of the public importance of the proper interpretation and uniform application of Rule 23.1 of the Federal Rules of Civil Procedure, a writ of certiorari should issue to review the judgment and opinion of the Fifth Circuit.

Respectfully submitted,



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December 2, 1969

APPENDIX A

Rule 23.1, Federal Rules of Civil Procedure

Rule 23.1. Derivative Actions by Shareholders.

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

APPENDIX B

In the

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 26130

PHILIP B. BATESON,
Plaintiff-Appellant,

versus

MAGNA OIL CORPORATION, et al.,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas

---

(August 11, 1969)

Before THORNBERRY and SIMPSON, Circuit Judges, and CASSIBRY, District Judge.

THORNBERRY, Circuit Judge: The question presented is whether a stockholder who sold his stock and shortly thereafter re-acquired stock in the corporation for the purpose of filing a long-planned stockholders' derivative suit has standing to maintain the suit under Rule 23.1 of the Federal Rules of Civil Procedure. We hold that he does.

Appellant filed a stockholders' derivative suit on behalf of Magna Oil Corporation against the directors of the corporation. He seeks recovery for the benefit of the corporation for damages resulting to the corporation from alleged acts of fraud, mismanagement, conspiracy, and breach of fiduciary duty on the part of the defendant directors. Appellant com-

plained of six transactions, five of which are alleged to be continuing transactions begun before the filing of the action and continuing at the time of the filing of the suit.[1]

The five transactions that are alleged to be continuous in nature are: (1) That defendant Howell caused Magna to advance him money on open account and promissory note. (2) That defendant Howell caused Magna to buy an airplane which is used more for the benefit of Howell than for the Corporation. (3) That defendant Howell has caused Magna to pay him and his brother excessive salaries and expense allowances. (4) That defendant Howell has caused the Corporation's property to be mortgaged at a nearly prohibitive rate in order to secure the payment of Howell's personal indebtedness. (5) That defendant Howell has caused certain of Magna's oil and gas properties to be mismanaged.

Appellant owned several hundred shares of Magna stock continuously from 1956 to May 5, 1967. On the latter date all of his Magna stock was sold. Appellant stated in his deposition that he had intended to retain one or two hundred shares because "he had long since planned this suit." On July 21, 1967, appellant bought one hundred shares of Magna stock for the stated purpose of bringing this suit. He filed suit on September 21, 1967. The lower court dismissed the action, apparently on the basis that the "contemporaneous ownership" requirement of Rule 23.1 had not been met.[2] Appellant appeals that decision.

[1]The sixth transaction complained of involves insider short-swing profits and an alleged violation of the Securities Exchange Act of 1934. It has been held that since an action to recover insider short-swing profits may be brought "by the owner of any security," 15 U.S.C.A. § 78p, plaintiff need not allege that he was a stockholder at the time of the transaction complained of *Blau v. Mission Corp.*, 2d Cir. 1954, 212 F. 2d 77, cert. denied, 347 U.S. 1016, 74 S.Ct. 872, 98 L.Ed. 1138.

[2]Rule 23.1 requires, inter alia, that in a stockholder's derivative action, the complaint shall allege "that the plaintiff was a shareholder . . . at the time of the transaction of which he complains." This requirement serves the dual purpose of preventing a collusive attempt to invoke federal jurisdiction, *Hawes v. City of Oakland*, 1882, 104 U.S. 450, 26 L.Ed. 827, and of preventing a person from buying a lawsuit.

The Rule makes it clear that one who buys stock in the corporation cannot maintain a stockholders' derivative suit if the wrongs complained of were completed before his acquisition of stock. However, where the complaint charged continuing wrongs, occurring at the time plaintiff owned stock, the complaint should not be dismissed on defendant's contention that the claims actually arose prior to the time plaintiff acquired his stock. 1 Barron & Holtzoff, *Federal Practice and Procedure* § 566, p. 303 (Wright ed. 1961); *Hoover v. Allen*, D.C.N.Y. 1960, 180 F. Supp. 263. In other words, the requirement that a shareholder must have owned stock at the time of the wrong of which he complains may be satisfied if the wrong is a continuing one, that is, if it "spans the plaintiff's ownership, or if new elements in a pattern of wrongful conduct occur after acquisition." Prunty, *Business Associations*, 35 N.Y.U.L. Rev. 1468 (1960).

This Court has set forth certain guidelines and tests for continuing transactions. In *Palmer v. Morris*, 5th Cir. 1963, 316 F.2d 649, the plaintiff charged the defendants with wrongdoing for certain transactions entered into prior to plaintiff's acquisition of the stock. It was alleged, however, that the company was still paying out sums of money pursuant to the earlier transactions and that these sums of money, both in the form of allegedly non-beneficial services for the company and in the form of allegedly exorbitant rentals, were still being made. The Court stated:

> Each of the counts . . . sufficiently stated the facts and circumstances touching on the alleged illegality of the payments currently being made so that these counts could not be dismissed as dealing only with transactions that had completely occurred and been terminated prior to plaintiff's acquisition of his stock. We are unable upon the basis of the record itself to determine that as a matter of law these counts failed to assert illegal conduct by the officers of the company subsequent to the acquisition of the stock by the plaintiff and at a time when he had a right to complain thereabout.

Id. at 650.

The matters complained of in the present case are not wrongs that have "completely occurred and been terminated prior to plaintiff's acquisition of his stock," and therefore, under the *Palmer* test, are continuing wrongs. Thus it would seem that appellant has met the requirement of owning stock at the time of the wrong complained of because the alleged wrongs were continuing at the time he re-acquired stock in Magna.

Appellees claim, however, that this suit was properly dismissed because appellant had knowledge of the alleged wrongs at the time he re-acquired his stock, and stock acquired with such knowledge cannot give standing to sue regardless of whether the allegedly wrongful acts were "continuing wrongs." In support of this argument, appellees place strong reliance on *Kenrich Corp. v. Miller*, 3d Cir. 1967, 377 F.2d 312, in which the court stated that one who was a stockholder at the time of an alleged intracorporate wrong and *sells* his stock with knowledge of the wrong loses any rights he may have had to bring suit in behalf of the corporation. That case, however, is not in point. There, the plaintiff had been the president and principal stockholder in the company, but he had sold all of his stock two years before the suit was instituted. He sought to maintain the suit by way of an assignment from another stockholder, and there was a finding that the assignment was champertous. Clearly, there was strong reason for applying estoppel principles against that plaintiff, whose apparent purpose in maintaining the derivative suit was to gain personal profit.

Estoppel principles will also work to deny standing to a plaintiff who *buys* stock with knowledge of the wrongs of which he complains. *See, e.g., Von Schlemmer v. Keystone Life Ins. Co.*, 121 La.2d 987, 46 So. 991 (1908); *Wagner Electric Corporation v. Hydraulic Brake Co.*, 269 Mich. 560, 257 N.W. 884 (1934). While a *stranger* to the corporation who buys stock with knowledge of the alleged wrongs may not maintain a derivative action even if the wrongs complained of are continuing wrongs, that rule is not applicable here. Appellant is no stranger to the corporation. He

was a long-time stockholder of Magna who apparently was concerned with the management of the company, and had planned to bring a derivative suit as early as April, 1966. Although it is true that he sold his stock (allegedly through inadvertence), he bought back a hundred shares in the corporation shortly thereafter. He bears no resemblance to the outsider who finds out about intracorporate misconduct and buys stock to foment litigation. Appellees' argument that appellant does not have standing to maintain this action loses sight of the purpose of Rule 23.1. That purpose is to prevent the federal court from being used to litigate purchased grievances or from becoming a party to speculative suits against corporations. *Cohen v. Beneficial Industrial Loan Corp.*, 1949, 337 U.S. 541, 556, 69 S. Ct. 1221, 1230, 93 L.Ed. 1541. Certainly, it cannot be said that appellant is litigating a purchased grievance. He is not a speculative litigator Therefore, it would exalt form over substance to hold that appellant did not have standing to maintain this stockholders' derivative action. Appellant should have his day in court.

The order of the trial court dismissing the Complaint was erroneous and the order is VACATED and set aside. The case is REMANDED to the trial court for proceedings not inconsistent with this opinion.

In the

United States Court of Appeals

FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1968

No. 26130

D. C. Docket No. 3-2241-Civil Action

PHILIP B. BATESON,
Plaintiff-Appellant,

versus

MAGNA OIL CORPORATION, ET AL,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas.

Before THORNBERRY and SIMPSON, Circuit Judges, and CASSIBRY, District Judge.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, vacated; and that this cause be, and it is hereby remanded to the said District Court for proceedings not inconsistent with the opinion of this Court;

It is further ordered that defendants-appellees pay to plaintiff-appellant the costs on appeal to be taxed by the Clerk of this Court.

August 11, 1969

Issued a Mandate:

In the

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 26130

PHILIP B. BATESON,

Appellant,

versus

MAGNA OIL CORPORATION, ET AL,

Appellees.

Appeal from the United States District Court for the Northern District of Texas

---

ON PETITIONS FOR THE REHEARING

(October 23, 1969)

Before THORNBERRY and SIMPSON, Circuit Judges, and CASSIBRY, District Judge

PER CURIAM: It is ORDERED that the petitions for rehearing filed the above entitled and numbered cause be and the same are hereby denied, except that the first sentence of the first paragraph on page 5 of the slip opinion dated August 11, 1969, is modified to read as follows: "With the possible exception of transaction (1), the matters complained of in the present case are not wrongs that have 'completely occurred and been terminated prior to plaintiff's acquisition of his stock,' and therefore, under the *Palmer* test, are continuing wrongs."

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In the

Supreme Court of the United States

OCTOBER TERM, 1969

Nos. 926 and 892

DUDLEY E. BINYON and
MAGNA OIL CORPORATION, ET AL
Petitioners,

v.

PHILIP B. BATESON
Respondent.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

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In the

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OCTOBER TERM, 1969

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v.

PHILIP B. BATESON

Respondent.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF FOR RESPONDENT IN OPPOSITION

CITATION TO OPINION BELOW

The opinion of the Court of Appeals is reported at 414 F. 2d 128, and is printed in Appendix A hereto, infra, page A-1.

QUESTIONS PRESENTED

1. Whether the opinion below conflicts with *Weinhaus v. Gale*, 237 F. 2d 197 (7th Cir. 1956) and *Henis v. Compania*

Agricola de Guatemala, 210 F. 2d 950 (3rd Cir. 1954), 116 F. Supp. 223 (U.S. Del. 1953), which decisions hold that a plaintiff in a stockholder derivative suit may not predicate standing to sue under Rule 23.1 on a mere allegation of continuing wrongs without any basis in his complaint to support such allegation.

2. Whether the opinion below conflicts with *Cohen v. Beneficial Industrial Loan Corp.,* 337 U.S. 541 (1949) as to whether under Rule 23.1 Respondent would have standing to bring a stockholder derivative action for Petitioners' continuing wrongs to Magna.

3. Whether the opinion below conflicts with *Kenrich Corp. v. Miller,* 377 F. 2d 312 (3rd Cir. 1967) as to whether under Rule 23.1 a stockholder who held stock during the entire time of the transactions he complains of except for a period of two and a half months, who knew of some of the transactions during that same time he held stock, who sold his stock but shortly thereafter repurchased stock and sued for all transactions continuing at the time of his repurchase of stock as continuing wrongs, has standing to sue.

STATEMENT OF THE CASE

The Statement of Facts in Petitioners' Petitions are generally complete and accurate except as set out below.

1. Petitioners fail to mention the transactions alleged in Respondent's Amended Original Complaint to have their inceptions after Respondent's July 22, 1967 repurchase of stock, concerned with mismanagement of St. John Gas Field

and the unauthorized use of company funds to pay G. B. Howell's personal apartment rent (R. 97-9 and 96-7). These transactions were not mentioned by the Fifth Circuit in its opinion as they were not required to support same.

2. At the time of filing the suit on September 21, 1967, Respondent was the holder of one hundred (100) shares of Magna stock, and has continuously held and owned said one hundred (100) shares of stock from July 21, 1967, to the filing of the suit on September 21, 1967. Moreover, the Fifth Circuit found that Respondent owned several hundred shares of Magna stock continuously from 1956 to May 5, 1967 (infra, page A-2).

3. Petitioner Binyon on page 6 and Petitioners' Magna, et al, on page 4 of their respective Petitions state that the allegation by Respondent in his Amended Original Complaint concerning Petitioner G. B. Howell's violation of 15 U.S.C.A. § 78p dealing with insider restrictions would only involve Howell and none of the other Petitioners. However, such is obviously not necessarily true since discovery, *entirely denied to* Respondent in the District Court, could easily show complicity, assistance, knowledge, and acquiescence of the other Director Petitioners in G. B. Howell's insider violation.

ARGUMENT

Petitioners' reasons for granting the writ are primarily asserted conflicts between the opinion below and three opinions of other Circuit Courts, *Weinhaus v. Gale*, 237 F. 2d

197 (7th Cir. 1956), *Henis v. Compania Agricola de Guatemala*, 210 F. 2d 950 (3rd Cir. 1954), 116 F. Supp. 223 (U.S. Del. 1953), and *Kenrich Corp. v. Miller*, 377 F. 2d 312 (3rd Cir. 1967), and an asserted conflict between the opinion below and the opinion of this Court in *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949). Petitioners' Petitions contain in addition, although not urged specifically as reasons for granting the writ, their individual conclusions as to the true meaning and purpose of Rule 23.1 and a group of state decisions in shareholder derivative suits, all of which are offered as general support of Petitioners' position and to convey the impression that the court below erred in its holdings.

Respondent's reply, to be developed in this Brief in Opposition, is that Petitioners' asserted conflicts are illusory and that the decision of the Fifth Circuit below is clearly correct.

(1) Petitioners argue that the *Weinhaus* and *Henis* cases, supra, conflict with the Fifth Circuit opinion (Binyon's Petition: Reason (1), pages 7-10; Magna's, et al, Petition: Reason (3), page 7). The first step in this argument in both Petitions is to state the holding in *Weinhaus* and *Henis;* namely, that the mere allegation in a plaintiff's complaint that wrongs continued after he purchased his stock, without any basis in the complaint to support such allegation, is insufficient to satisfy the requirement of contemporaneous ownership under Rule 23.1. Petitioners get no argument from Respondent at this point.

However, Petitioner Binyon, as the concluding part of his argument, and without so much as quoting a single statement from the Fifth Circuit opinion, asserts in effect that the Fifth Circuit's language may be "paraphrased" to say that the mere allegation that a wrong is continuing, without more, is in fact sufficient to fulfill the requirement as to contemporaneous ownership under Rule 23.1. In other words, according to Petitioner Binyon the Fifth Circuit opinion stands for exactly the opposite position to that expressed in *Weinhaus* and *Henis*. However, nothing could be further from the truth and a reading of the fifth and sixth paragraphs of the Court's opinion (infra, page A-3), which Petitioner refers to in support of his view, precludes any such interpretation. In the sixth paragraph the Court cites *Palmer v. Morris*, 316 F. 2d 649 (5th Cir. 1963) as authority on the question of guidelines and tests for continuing transactions:

> " 'Each of the counts . . . sufficiently stated the facts and circumstances touching on the alleged illegality of the payments currently being made so that these counts could not be dismissed as dealing only with transactions that had completely occurred and been terminated prior to plaintiff's acquisition of his stock. We are unable upon the basis of the record itself to determine that as a matter of law these counts failed to assert illegal conduct by the officers of the company subsequent to the acquisition of the stock by the plaintiff and at a time when he had a right to complain thereabout.' *Id.* at 650."

The above quotation is obviously not simply consistent with *Weinhaus* and *Henis* but is in complete support of their mutual holding that the counts in plaintiff's complaint must

sufficiently state a basis for the allegation of continuing transactions (or continuing wrongs).

Petitioners Magna, et al, on the other hand, in their attempt to establish a conflict, neither endeavor to quote specific language of the Fifth Circuit opinion, nor to paraphrase any of its language, nor to refer to any particular paragraph or paragraphs, nor to do anything at all except to put on record their conviction once again that the Fifth Circuit opinion conflicts with *Weinhaus* and *Henis.*

Petitioners Magna, et al, do, however, make reference in passing to a contention they had maintained earlier in the proceedings; namely, that Respondent's Original Complaint did not sufficiently state a basis for the allegation of "continuing wrongs." However, very conspicuous by their absence are any mention of Respondent's First Amended Original Complaint, of which the adequacy of its allegations as to continuing wrongs is uncontroverted; any arguments as to why Respondent would not be entitled to amend; any arguments as to what connection this particular contention has to the Fifth Circuit opinion; or any arguments as to the relevance of this particular contention to any ground upon which Petitioners may petition the Supreme Court for a writ of certiorari.

(2) Petitioners assert as a second reason for granting certiorari that the *Cohen* case, supra, conflicts with the Fifth Circuit opinion in the application of Rule 23.1 (Binyon's Petition: Reason (2), pages 10-13; Magna's, et al, Petition: Reason (5), page 8-9). This position is maintained

vigorously and at considerable length. However, almost all of Petitioners' efforts in this regard are given over to developing and urging their own individual conclusions and feelings and there is virtually no discussion of the cases themselves or the conflict which Petitioners maintain is present.

That the two cases are not even remotely in point is readily seen by examining them. The central issues in *Cohen* were the constitutionality of a New Jersey statute requiring a stockholder-plaintiff in a stockholder derivative action to put up security for his derivative action, and the applicability of this statute in federal district court in a diversity case. The Court ruled that the statute was constitutional and that it applied in federal district court under the facts of that case. In short, *Cohen* is not in point. In the first place, *Cohen* does not purport to be a discussion of the purpose and application of Rule 23.1 or one of its parent rules. Rather it is a discussion as to whether the New Jersey statute was substantive or had some substantive aspect or, on the other hand, was wholly procedural and therefore whether it should be applied in addition to Rule 23. Secondly, and of equal if not more importance, is the fact that *Cohen* does not involve a plaintiff who alleged continuing wrongs as his cause of action and that, moreover, neither Justice Jackson's majority opinion nor the other opinions in the case discuss or mention the doctrine or the concept of continuing wrongs.

The *Cohen* case is simply of no help one way or the other in the present lawsuit and consequently can be of no help to Petitioners on petition for certiorari.

(3) Petitioners maintain as a third reason for granting certiorari that the *Kenrich* case, supra, conflicts with the Fifth Circuit opinion as to whether a stockholder who held stock during the entire time of the transactions he complains of except for a period of two and a half months, who knew of some of the transactions during that same time he held stock, who sold his stock but shortly thereafter repurchased stock and sued for all transactions continuing at the time of his repurchase of stock as continuing wrongs, has standing to sue under Rule 23.1. In addition, Petitioners argue that the Fifth Circuit opinion is erroneous. (Binyon's Petition: Reason (3), pages 13-17; Magna's, et al, Petition: Reason (2), pages 5-6.)

In reply, Respondent states that again Petitioners have gone far afield in their efforts to establish a conflict; that the *Kenrich* case and the present case are very dissimilar and, contrary to Petitioners' contention, were decided on very different facts and issues; that, accordingly, as shown below, the present case may be distinguished in several important respects from *Kenrich;* and that the Fifth Circuit opinion in the present case is clearly correct.

In *Kenrich*, the plaintiff was a former president, director and shareholder who had sold his stock and had ceased to hold all corporate office. Two (2) years later he brought suit upon the basis of an assignment agreement from the Kenrich Corporation of its cause of action against the former directors of a corporation which had been merged into the

Kenrich Corporation, the terms of which assignment agreement having been the following:

> "Further, Kline shall have the right to institute suit on behalf of Kenrich and *retain 66⅔% of the proceeds thereof* after payment of legal and all other expenses and fees in connection therewith (for which he shall be liable), in the event Kenrich shall fail to prosecute suit within 90 days after Kline shall have presented to it the factual basis for such claim, together with his request that it so prosecute. However, if upon the making of such request, Kenrich shall proceed with due diligence to prosecute such suit, at its own expense, then Kline shall be entitled to 25% of such proceeds. If in the latter event, suit is not instituted by Kenrich within 90 days, then Kline may proceed as set forth in the first sentence of this subparagraph." (Kenrich, supra, at 314.) (Emphasis is Respondent's).

The Third Circuit in *Kenrich* discussed Plaintiff Kline's standing to sue, both in a direct action and in a stockholder's derivative action. The Court held that the Plaintiff could not sue directly since the assignment agreement was champertous and violated the laws of the forum state of Pennsylvania. The Court's second and most important holding was that the Plaintiff could not sue derivatively since he was neither the legal nor equitable owner of stock at the time of suit, and therefore could not be recognized as having an interest which could be vindicated in equity. The Court stated:

> "True, a *stockholder* has interest in such claims and, if the corporation refuses to act, may vindicate that interest in equity through a stockholder's derivative suit . . . But in Delaware where this business is incorporated, as elsewhere, *only one who is the legal or*

equitable owner of stock at the time of suit is recognized as thus interested." (*Kenrich*, supra, page 314.) (Emphasis is Respondent's).

Briefly, the wide disparity of facts and of issues between *Kenrich* and the present case may be summarized as follows: in *Kenrich*, the plaintiff held no shares at the time of suit and was not financially interested in the corporation; rather, the plaintiff sued on the basis of a champertous assignment agreement which set out his percentage of whatever recovery he was able to obtain; moreover, plaintiff did not charge continuing wrongs as his cause of action; further, the Court held that plaintiff had no standing to sue derivatively inasmuch as he had sold all of his stock, had none at the time of filing of the suit, and therefore obviously was not a proper person to bring a stockholder's derivative suit; and finally, it should be stressed that *Kenrich* does not even purport to be a discussion of Rule 23.1, or one of its parent rules nor is Rule 23.1 mentioned anywhere in the entire opinion.

On the other hand, in the present case, Respondent was in fact the holder of stock at the time of institution of suit and was consequently financially interested in Magna; further, Respondent sued derivatively and in behalf of the stockholders generally as a representative of the stockholders and not by way of a percentage interest under an illegal and champertous assignment of a cause of action; moreover, Respondent charged continuing wrongs primarily as his cause of action; and finally, the Fifth Circuit opinion in the present case may be readily distinguished from the opinion in the *Kenrich* case in that the Fifth Circuit points out that the plaintiff in *Kenrich* owned no stock, that he did not

assert standing to sue on the basis of stock ownership but rather on the basis of an illegal and champertous assignment, and that therefore by instituting a suit on such an agreement, plaintiff was not pursuing a suit for recovery in behalf of shareholders but a suit which was expressly an instrument for the plaintiff's personal recovery. And, lastly, the Fifth Circuit opinion is clearly an opinion on Rule 23.1, whereas the *Kenrich* opinion equally clearly was not.

Hence, the *Kenrich* case is simply not in point.

(4) As a fourth reason for granting certiorari, Petitioners argue briefly that the Fifth Circuit erred in the present case by failing to apply the substantive law of Delaware (Magna's, et al., Petition: Reason (4), pages 7-8; Binyon does not join in this argument). Petitioners contend that in this case the state and federal laws are the same and therefore both should be applied so as to avoid forum shopping. The end result, Petitioners stress, would be to bar Respondent's suit.

As a preface to Respondent's reply, Respondent would point out that although the meaning of Petitioners' argument is not entirely clear, he nevertheless offers the following in reply. First, Petitioners state no reason as to the relevance of the law of the State of Delaware to grounds upon which a petition for writ of certiorari may be granted. Second, Petitioners offer no evidence and in fact could offer no evidence to support Petitioners' implied premise that the Delaware law conflicts with the Fifth Circuit opinion. And third, if as Petitioners say, (and Respondent would not deny it) federal and Delaware law are the same in this case, it

would seem to make little or no difference which law is applied.

(5) Petitioners Magna, et al., as a fifth reason for granting certiorari advance the broad contention that the decision of the Fifth Circuit is "in conflict with every authority which has considered this question." (Magna's, et al., Petition: Reason (5), pages 8-9; Binyon does not join in this argument). In support of this contention, Petitioners seek to draw the Court's attention to three (3) Delaware cases and also to one (1) New York case: *Rosenthal v. Burry Biscuit Corp.*, 60 A. 2d 106 (Del. Ch. 1948); *Maclary v. Pleasant Hills, Inc.*, 109 A. 2d 830 (Del Ch. 1954); *Newkirk v. W. J. Rainey, Inc.*, 76 A. 2d 121 (Del Ch. 1950); and *Gresov v. Shattuck Denn Mining Corp.*, 243 N.Y.S. 2d 760 (N.Y. Sup. 1963).

In reply to this point, Respondent would state that despite the broad assertions in Petitioners' "fifth reason," Petitioners have not presented to the Court their reasoning for the conclusion that the above four cases conflict with the Fifth Circuit opinion or any reasoning as to how these four cases would be relevant to grounds for certiorari even if they did. Moreover, Respondent submits that these cases clearly do not present a conflict with the present case.

(6) Petitioners, in addition, at various places in their Petitions advance their individual conclusions and perceptions as to the meaning and purpose of Rule 23.1, citing in an abstract and inconclusive manner the cases Respondent has already argued are not in point (Respondent's Points 1, 2 & 3). According to Petitioners the Fifth Circuit violated

the spirit of Rule 23.1 when it held that Respondent was no stranger to Magna and therefore was not barred from bringing his suit.

Respondent would reply only that the Fifth Circuit opinion, far from offending the spirit of Rule 23.1, did in fact understand and preserve its real purpose when it recognized that Respondent "bears no resemblance to the outsider who finds out about intra-corporate misconduct and buys stock to foment litigation" and that rather it is the Petitioners who have lost sight of the purpose of Rule 23.1 (Infra, page A-5). The decision of the Fifth Circuit is clearly correct.

CONCLUSION

For the foregoing reasons, Respondent respectfully submits that this petition for a writ of certiorari should be denied.

January 20, 1970.

Robert H. Hughes

ROBERT H. HUGHES

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APPENDIX A
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 26130

PHILIP B. BATESON,
Plaintiff-Appelllant,

versus

MAGNA OIL CORPORATION, et al.,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas

---

(August 11, 1969)

Before THORNBERRY and SIMPSON, Circuit Judges, and CASSIBRY, District Judge.

THORNBERRY, Circuit Judge: The question presented is whether a stockholder who sold his stock and shortly thereafter re-acquired stock in the corporation for the purpose of filing a long-planned stockholders' derivative suit has standing to maintain the suit under Rule 23.1 of the Federal Rules of Civil Procedure. We hold that he does.

Appellant filed a stockholders' derivative suit on behalf of Magna Oil Corporation against the directors of the corporation. He seeks recovery for the benefit of the corporation for damages resulting to the corporation from alleged acts of fraud, mismanagement, conspiracy, and breach of

fiduciary duty on the part of the defendant directors. Appellant complained of six transactions, five of which are alleged to be continuing transactions begun before the filing of the action and continuing at the time of the filing of the suit.[1]

The five transactions that are alleged to be continuous in nature are: (1) That defendant Howell caused Magna to advance him money on open account and promissory note. (2) That defendant Howell caused Magna to buy an airplane which is used more for the benefit of Howell than for the Corporation. (3) That defendant Howell has caused Magna to pay him and his brother excessive salaries and expense allowances. (4) That defendant Howell has caused the Corporation's property to be mortgaged at a nearly prohibitive rate in order to secure the payment of Howell's personal indebtedness. (5) That defendant Howell has caused certain of Magna's oil and gas properties to be mismanaged.

Appellant owned several hundred shares of Magna stock continuously from 1956 to May 5, 1967. On the latter date all of his Magna stock was sold. Appellant stated in his deposition that he had intended to retain one or two hundred shares because "he had long since planned this suit." On July 21, 1967, appellant bought one hundred shares of Magna stock for the stated purpose of bringing this suit. He filed suit on September 21, 1967. The lower court dismissed the action, apparently on the basis that the "con-

[1] The sixth transaction complained of involves insider short-swing profits and an alleged violation of the Securities Exchange Act of 1934. It has been held that since an action to recover insider short-swing profits may be brought "by the owner of any security," 15 U.S.C.A. § 78p, plaintiff need not allege that he was a stockholder at the time of the transaction complained of. *Blau v. Mission Corp.*, 2d Cir. 1954, 212 F. 2d 77, cert. denied, 347 U.S. 1016, 74 S. Ct. 872, 98 L. Ed. 1138.

[2] Rule 23.1 requires, inter alia, that in a stockholder's derivative action, the complaint shall allege "that the plaintiff was a shareholder . . . at the time of the transaction of which he complains." This requirement serves the dual purpose of preventing a collusive attempt to invoke federal jurisdiction, *Hawes v. City of Oakland*, 1882, 104 U.S. 450, 26 L.Ed. 827, and of preventing a person from buying a lawsuit.

temporaneous ownership" requirement of Rule 23.1 had not been met.[2] Appellant appeals that decision.

The Rule makes it clear that one who buys stock in the corporation cannot maintain a stockholders' derivative suit if the wrongs complained of were completed before his acquisition of stock. However, where the complaint charged continuing wrongs, occurring at the time plaintiff owned stock, the complaint should not be dismissed on defendant's contention that the claims actually arose prior to the time plaintiff acquired his stock. 1 Barron & Holtzoff, *Federal Practice and Procedure* § 566, p. 303 (Wright ed. 1961); *Hoover v. Allen*, D.C.N.Y. 1960, 180 F. Supp. 263. In other words, the requirement that a shareholder must have owned stock at the time of the wrong of which he complains may be satisfied if the wrong is a continuing one; that is, if it "spans the plaintiff's ownership, or if new elements in a pattern of wrongful conduct occur after acquisition." Prunty, *Business Associations*, 35 N.Y.U.L. Rev. 1468 (1960).

This Court has set forth certain guidelines and tests for continuing transactions. In *Palmer v. Morris*, 5th Cir. 1963, 316 F. 2d 649, the plaintiff charged the defendants with wrongdoing for certain transactions entered into prior to plaintiff's acquisition of the stock. It was alleged, however, that the company was still paying out sums of money pursuant to the earlier transactions and that these sums of money, both in the form of allegedly non-beneficial services for the company and in the form of allegedly exorbitant rentals, were still being made. The Court stated:

> Each of the counts . . . sufficiently stated the facts and circumstances touching on the alleged illegality of the payments currently being made so that these counts could not be dismissed as dealing only with transactions that had completely occurred and been terminated prior to plaintiff's acquisition of his stock. We are unable upon the basis of the record itself to determine that as a matter of law these counts failed to assert illegal conduct by the officers of the company

> subsequent to the acquisition of the stock by the plaintiff and at a time when he had a right to complain thereabout.

The matters complained of in the present case are not wrongs that have "completely occurred and been terminated prior to plaintiff's acquisition of his stock," and therefore, under the *Palmer* test, are continuing wrongs. Thus it would seem that appellant has met the requirement of owning stock at the time of the wrong complained of because the alleged wrongs were continuing at the time he re-acquired stock in Magna.

Appellees claim, however, that this suit was properly dismissed because appellant had knowledge of the alleged wrongs at the time he re-acquired his stock, and stock acquired with such knowledge cannot give standing to sue regardless of whether the allegedly wrongful acts were "continuing wrongs." In support of this argument, appellees place strong reliance on *Kenrich Corp. v. Miller*, 3d Cir. 1967, 377 F.2d 312, in which the court stated that one who was a stockholder at the time of an alleged intracorporate wrong and *sells* his stock with knowledge of the wrong loses any rights he may have had to bring suit in behalf of the corporation. That case, however, is not in point. There, the plaintiff had been the president and principal stockholder in the company, but he had sold all of his stock two years before the suit was instituted. He sought to maintain the suit by way of an assignment from another stockholder, and there was a finding that the assignment was champertous. Clearly, there was strong reason for applying estoppel principles against that plaintiff, whose apparent purpose in maintaining the derivative suit was to gain personal profit.

Estoppel principles will also work to deny standing to a plaintiff who *buys* stock with knowledge of the wrongs of which he complains. *See, e.g., Von Schlemmer v. Keystone Life Ins. Co.*, 121 La.2d 987, 46 So. 991 (1908); *Wagner Electric Corporation v. Hydraulic Brake Co.*, 269 Mich. 560, 257 N.W. 884 (1934). While a *stranger* to the corporation who buys stock with knowledge of the alleged wrongs may

not maintain a derivative action even if the wrongs complained of are continuing wrongs, that rule is not applicable here. Appellant is no stranger to the corporation. He was a long-time stockholder of Magna who apparently was concerned with the management of the company, and had planned to bring a derivative suit as early as April, 1966. Although it is true that he sold his stock (allegedly through inadvertence), he brought back a hundred shares in the corporation shortly thereafter. He bears no resemblance to the outsider who finds out about intracorporate misconduct and buys stock to foment litigation. Appellees' argument that appellant does not have standing to maintain this action loses sight of the purpose of Rule 23.1. That purpose is to prevent the federal court from being used to litigate purchased grievances or from becoming a party to speculative suits against corporations. *Cohen v. Beneficial Industrial Loan Corp.*, 1949, 337 U.S. 541, 556, 69 S. Ct. 1221, 1230, 93 L. Ed. 1541. Certainly, it cannot be said that appellant is litigating a purchased grievance. He is not a speculative litigator. Therefore, it would exalt form over substance to hold that appellant did not have standing to maintain this stockholders' derivative action. Appellant should have his day in court.

The order of the trial court dismissing the Complaint was erroneous and the order is VACATED and set aside. The case is REMANDED to the trial court for proceedings not inconsistent with this opinion.

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1968

No. 26130

D.C. DOCKET NO. 3-2241 CIVIL ACTION

PHILIP B. BATESON,
Plaintiff-Appelllant,

versus

MAGNA OIL CORPORATION, et al.,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas

Before THORNBERRY and SIMPSON, Circuit Judges, and CASSIBRY, District Judge.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, vacated; and that this cause be, and it is hereby remanded to the said District Court for proceedings not inconsistent with the opinion of this Court;

It is further ordered that defendants-appellees pay to plaintiff-appellant the costs on appeal to be taxed by the Clerk of this Court.

August 11, 1969

Issued as Mandate:

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 26130

PHILIP B. BATESON,

Appellant,

versus

MAGNA OIL CORPORATION, ET AL,

Appellees.

Appeal from the United States District Court for the Northern District of Texas

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ON PETITIONS FOR REHEARING

(October 23, 1969)

Before THORNBERRY and SIMPSON, Circuit Judges, and CASSIBRY, District Judge

PER CURIAM: It is ORDERED that the petitions for rehearing filed the above entitled and numbered cause be and the same are hereby denied, except that the first sentence of the first paragraph on page 5 of the slip opinion dated August 11, 1969, is modified to read as follows: "With the possible exception of transaction (1), the matters complained of in the present case are not wrongs that have 'completely occurred and been terminated prior to plaintiff's acquisition of his stock,' and therefore, under the *Palmer* test, are continuing wrongs."